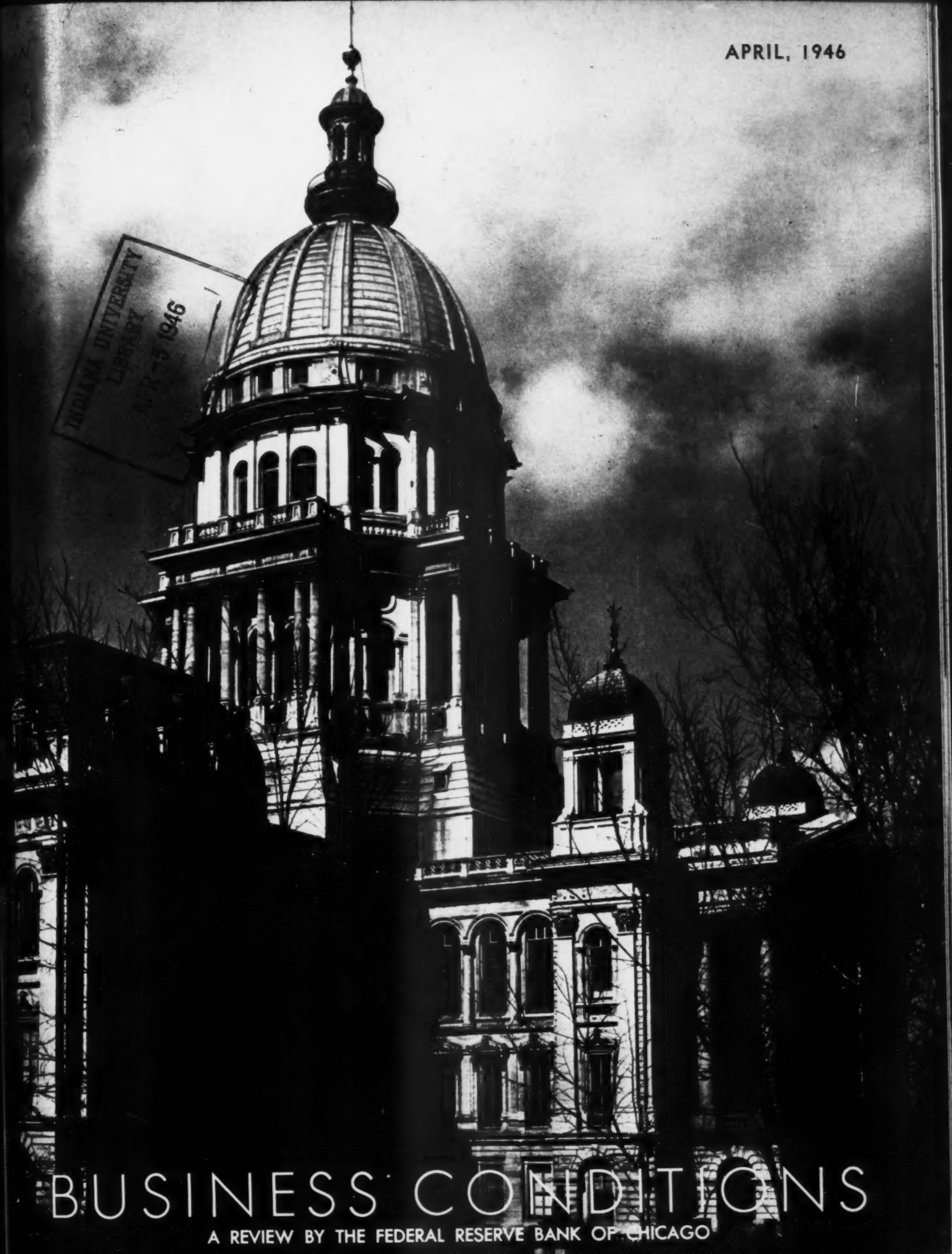
APRIL, 1946



BUSINESS CONDITIONS

A REVIEW BY THE FEDERAL RESERVE BANK OF CHICAGO

Net Farm Income Levels Off

Expenses Check Rise in Farm Income

The appraisal of economic conditions on the farm and in the farm business is usually confined, especially when the discussion deals with state conditions, to the statement of gross returns from farming. In such statements it is customary to give the dollar figures by states of the cash receipts from marketing of farm products.

Obviously a better measure of economic level for the farm business is the net realized income from operations after the expenses of production have been deducted. Heretofore, reliable state estimates have not been available as to the annual expenses of operation. The United States Department of Agriculture has recently made available a series of estimates of the expenses of production and the net realized income per farm by states. These estimates also include measures of gross farm income and cover the war years through 1944.

Gross income differs from the more frequently published figures on state totals of cash receipts from farm marketings. It is larger than the total of cash receipts alone because there are added to the latter the value of farm food and fuel products consumed by the farm family and laborers on the farm and the annual rental value of farm residences. It is necessary to add these items in arriving at estimates of net income because they constitute a part of the economic return to the farm enterprise, and there is also involved in providing them some part or proportion of the expenses of farm production and operation. For similar reasons Government payments to farm operators (but not including payments to landlords not living on farms) are included; a substantial part of such payments was made to farmers for the performance of certain practices involving outlays for the expenses incurred for those practices. After deducting operating expenses from gross income, the resulting measure of realized net income indicates the return available to the farm operator and his family for current living and savings.

Such estimates are thus an improvement upon gross return figures as a measure of farm welfare, for production expenses are subject to considerable variation as a proportion of income as between different types of farm enterprise. Variations also arise from state to state and from year to year.

WAR-TIME RISE IN GROSS INCOME

Turning first to estimates of gross income, the estimates show that the average for the nation rose from just under \$1,700 per farm in 1939 to the high of \$4,280 for 1944. (1945 estimates are not yet available.) These averages include Government payments. The averages for the states of the Seventh Federal Reserve District showed similar striking advances. For Illinois the rise was from \$2,769 in 1939 to \$6,364 in 1944. The gross income for Indiana advanced from \$1,800 to \$4,400 in 1944, while the increase for Iowa was from \$3,300 in 1939 to the peak of nearly \$8,200 reached in 1943, but the 1944 figure was substantially lower at a little over \$7,600 per farm.

Gross farm income per farm more than doubled in Michigan, rising from \$1,520 in 1939 to \$3,400 for 1944. The average for Wisconsin rose from \$1,845 per farm in 1939 to a war-time peak of over \$5,200 reached in 1944. During each of the war years the average gross income per farm was larger than the national average in all of the states of the Seventh Federal Reserve District except for Michigan, which averaged 10 to 15 per cent below the national figure.

Government payments during the war years was a substantial factor in the total of gross income, ranging among the states of the District from two per cent to seven per cent of the average per farm gross income. Such payments averaged about \$160 per farm during the period in Illinois, about \$100 for Indiana, and \$190 per farm in Iowa. The Michigan and Wisconsin averages were close to \$75 per farm, with the exception of the 1944 average for Wisconsin of \$342, due principally to the dairy payments program.

OPERATING EXPENSES RISE LESS THAN INCOMES

Because a substantial part of the operating expenses of farm enterprises are contractually or otherwise "fixed," farm expenses in a period of rising prices tend to increase less rapidly for a time than prices received for products. Nevertheless, they do rise substantially, and the recent war period has been no exception. Operating costs have risen materially, although they have not as yet caught up entirely with the rise in gross income. This is partly attributable to the fact that farm output per acre and per unit of other resources has been during recent years above what is considered to be normal.

For convenience in discussion, the operating and production expenses of United States farmers are grouped into nine major groups: (1) feed purchases accounted for about 19 per cent of the 1944 total expenses; (2) livestock purchases absorbed seven per cent of the total in that year; (3) fertilizer and lime expenditures were four per cent of the total; (4) cost of operating motor vehicles (cars, trucks, and tractors) absorbed eight per cent; (5) hired labor made up 19 per cent; (6) maintenance and depreciation on buildings and machinery was 15 per cent of the 1944 total; (7) taxes required four per cent; (8) farm-mortgage interest was two per cent of total expense; and (9) miscellaneous current operating expenses accounted for 22 per cent of total.

The pattern of relative importance of these groups of expense is roughly the same for the District as for the nation except that feed purchases are of slightly less importance, and costs of motor vehicle operation are a slightly larger proportion of the total. A substantially larger part of total expense is represented by both maintenance and deprecia-

(*Continued on Page 5*)

Illinois State Surplus and Debt—I

Working Cash Requirements of State Funds

Between December 31, 1940, and December 31, 1945, the aggregate revenues of the State government of Illinois were a half billion dollars in excess of its gross expenditures including the principal repayment of 55 million dollars of long-term bonds. Thus while retiring nearly one-third of its outstanding debt the State increased its cash balance from 246 million dollars to 755 million dollars. This three-fold increase in state cash is not, however, an unencumbered fund from which general state activities can be financed. The greater part of the five-year excess in revenue—62 per cent—is segregated in the Unemployment Trust Fund and reserved exclusively for the payment of future benefits to the unemployed. The General Revenue Fund and other regular operating funds of the State show an accumulation of 150 million dollars, or 30 per cent of the total, of which 139 million dollars has been appropriated for public works. Highway funds which are dedicated to debt service and the maintenance and construction of streets and roads account for approximately six per cent or 31 million dollars. The comparative balances for the various classes of state funds as of the end of 1940 and 1945 are shown in Table 1.

There is a degree of finality to the segregation of the Unemployment Compensation Fund balance which precludes serious consideration to its diversion for purposes other than benefits to the unemployed. Though for different reasons, much the same certainty of policy characterizes the use of balances in the highway funds. Many highway construction projects have been deferred during the war years, and since the yield from highway-user taxes was reduced by gasoline rationing in this period, the balance on hand, if anything, is insufficient to meet the demands that will be placed upon it. The General Revenue Fund balance, on the other hand, is still subject to changes in State policy. While the General Assembly has actually appropriated the entire balance for public works, the appropriations are contingent upon the approval of the Governor before expenditures from them can be made. The bulk of these postwar projects are for building construction and in view of the critical shortage of housing and active demand for commercial construction, it is highly unlikely that any but the most urgent state public works will be approved for construction in the current biennium. If the State adheres to a policy of not permitting its public works program to displace residential construction until the housing shortage becomes much less acute, the balance in the General Revenue Fund will be between 75 and 110 million dollars when expenditures and tax policies for the fiscal years ending in 1948 and 1949 are considered by the 1947 General Assembly.

TABLE 1
ILLINOIS STATE FUNDS
COMPARATIVE BALANCES DECEMBER 31, 1940-45
(In millions of dollars)

Fund	Cash Balance December 31 1940	Cash Balance December 31 1945	Increase in Balance
All Funds	245.7	755.2	509.5
Operating:			
General Revenue	8.9	155.1	146.2
Other Operating	13.2	19.1	5.9
Earmarked:			
Highway	29.9	60.7	30.8
Other Earmarked	1.1	6.5	5.4
Trust:			
Unemployment Compensation	188.1	505.8	317.7
Protest Fees	1.6	5.5	3.9
Other Trust	3.0	2.5	— .5

GOVERNMENT SURPLUSES AND DEFICITS

Cash balances in government accounts in excess of normal working requirements are relatively uncommon for major governmental units. While some small local taxing districts frequently hold a cash balance equivalent to three or four years' normal expenditure, a surplus of these dimensions is unheard of in the finances of states or large local units. State budgetary practice, despite the fact that it is usually on a biennial basis and thus involves long-run prognostications of revenues, price levels, and uncertain liabilities inherent in new legislative programs, has been sufficiently accurate in normal times—particularly in those states that do not have an excessive number of earmarked funds—to avoid casual deficits or large surpluses. The uncertainties of a 30-month forecast, however, in years of drastic change in economic conditions, have led to abnormal drains on or accretions to working balances.

Two views of governmental surpluses are common; while the difference relates solely to the period considered, care should be taken in distinguishing between them. The more popular concept regards a surplus as the amount which arises from a periodical balancing of past receipts and disbursements. Thus, the surplus for a given year is the difference between cash receipts and disbursements in that

THIS MONTH'S COVER
Illinois State Capitol in Springfield
(Photo—G. R. DuBois, Federal Reserve Camera Club)

year, and the surplus as of a given date is the cumulation of past surpluses and deficits to that date.

The other notion of surplus or deficit often referred to in government finance is a budgetary concept which projects from a known balance the net effect of estimated future revenues and expenditures at intervals up to the end of the budgetary period. Thus, governments periodically (usually at the outset of a fiscal year or a biennium) estimate future surpluses or deficits in this manner, and such estimates are continuously used during the months in which the budget is being considered to appraise the effect of tax and expenditure policies on their financial position. In this view, therefore, it is always necessary to know the extent to which the surplus as of a given time is encumbered by existing or expected expenditure authorizations or anticipated revenue declines, i.e., the surplus is a budgetary problem.

The relative significance of a given surplus can properly be appraised in terms of current or past tax receipts or the existing level of expenditure if recognition is given to the limitations involved in ignoring trends for the future. Unfortunately, uncertainties of policy and fact preclude the budgetary approach, even though it be granted that, as a guide to policy, it is ordinarily more satisfactory to analyze surpluses in light of the probable future receipts and anticipated requirements of state expenditure. A brief catalogue of the unknowns indicates the difficulties of the latter approach: the forecast of revenue yields and trends in the unit costs of state services, the appraisal of changes in the scope and extent of major expenditure programs, and a knowledge of the policy of the state on maintenance and replacement expenditures for highways and buildings. Thus, for example, most state governments charge outlays for state institutions, buildings, and highways to the year or years of their construction. No periodic allowance for depreciation is indicated in state accounts, and it is difficult to estimate without a thorough knowledge of the physical facilities involved what demands for capital expenditure and repair will be required in the immediate future. It is known, for example, that in common with much private enterprise during the war years, the capital investment of governments has been undermaintained and that replacement programs have been largely postponed. During early postwar years there will be substantial repair and construction programs in most of the states, but until the first postwar budgets are prepared, there is little information in state reports which permits even a rough estimate of the amount of such expenditure.

The most convenient and readily available measure of the accumulation of government surpluses is to be had by comparing treasury balances from one period to another. While data on receipts and expenditures are preferable as a source of information because of their other uses, these figures are often not readily available and seldom promptly compiled.

The data on balances show that within the past two and one-half decades, states generally have experienced one period (the early 1930's) in which their cash balances were drawn down and many were forced to incur operating deficits. It is also typical of state finance that during the past five years, surpluses have accrued owing to the unexpectedly high tax revenues in those years, a deliberate policy of accumulation as an anti-inflationary measure, the restrictions on capital construction, and the lag in over-all state expenditures relative to price and production trends. Actually, some states reduced their potential surpluses by maintaining prewar expenditure levels and reducing tax rates. Others held rather closely to the prewar expenditure level, maintained tax rates, and diverted the increased revenues from their tax systems into funds that have been permitted to accumulate for postwar expenditure programs. In still others the larger productivity of the major taxes has been used for aids to local government or the expansion of state services.

CASH BALANCES IN ILLINOIS FUNDS

In common with the majority of states, Illinois uses several separate funds to segregate its revenues and disbursements. Throughout the past 25 years, upwards of one hundred funds have at one time or another been employed by State officials in accounting for the State's receipts and expenditures. Some funds have had no more significance than subsidiary accounts in the General Revenue Fund, but others have been set up with specific earmarking for their deposits and drastic restrictions on withdrawals. In tracing the growth of surpluses or deficits, however, most of these restrictions and qualifications can be ignored.

For historical and comparative purposes, the General Revenue Fund and its subsidiary accounts have been kept separately. Additional funds which account for the State's other day-to-day activities have been grouped and designated as "other operating" funds. A particular fund has been classified as "operating" if the annual deposits to and withdrawals from it are made under rules that make it unlikely that any substantial balance or deficit will be permitted to occur. The majority of the State's funds meet this qualification. They are built up by transfers from General Revenue or some tax fund and disbursed for particular expenditure needs, as, for example, in the case of bond funds for interest and principal payments. A few funds are classified as "operating" even though they accumulate temporary surpluses. These surpluses, however, can be reduced by administrative action directing transfer to the General Revenue Fund. The broad designation of "other operating" funds, therefore, includes most of the State's regularly used funds. There has been little or no surplus accumulation in this group.

The balance in the Illinois General Revenue Fund has fluctuated widely during the past twenty-five years (see accompanying chart and tables). There have been four periods (1920-1923; 1927-1929; 1935-1938; 1942-1945) in which the Fund has been maintained at levels adequate to withstand seasonal changes, which were significant in the 'twenties, and to cushion temporarily drains resulting from unanticipated falling off in revenues. The Fund was actually "in the red" for two and a half years during the depression of the 'thirties, and its solvency was only attained

TABLE 2

CASH BALANCES IN ILLINOIS STATE FUNDS, 1920-45

(In millions of dollars)

Date	FUNDS							
	Total	Operating		Earmarked		Trust		
		General Revenue[1]	Other Operating[2]	Highway[3]	Other[4]	Unemployment Comp.	Protested Fees	Other[5]
1920—Mar. 31	18.7	12.6	1.6	3.9	—	—	—	.6
Jun. 30	27.5	16.7	3.3	7.0	—	—	—	.5
Sep. 30	26.6	15.8	4.0	5.5	—	—	—	1.3
Dec. 31	24.5	15.8	4.2	3.3	—	—	—	1.2
1921—Mar. 31	19.1	12.0	3.8	2.7	—	—	—	.6
Jun. 30	26.6	16.2	4.9	4.5	—	—	—	1.0
Sep. 30	26.9	18.0	5.2	2.3	—	—	—	1.4
Dec. 31	23.8	14.2	5.0	3.4	—	—	—	1.2
1922—Mar. 31	23.6	10.9	4.5	6.9	—	—	—	1.3
Jun. 30	29.9	13.5	4.4	11.1	—	—	—	.9
Sep. 30	28.6	16.1	5.6	5.7	—	—	—	1.2
Dec. 31	22.8	14.1	5.2	2.8	—	—	—	.7
1923—Mar. 31	25.4	9.9	4.7	10.2	—	—	—	.6
Jun. 30	28.4	15.4	5.8	6.6	—	—	—	.6
Sep. 30	27.3	15.7	6.4	3.7	*	—	—	1.4
Dec. 31	22.7	11.4	6.6	3.8	.2	—	—	.7
1924—Mar. 31	34.9	8.0	13.0	12.9	.2	—	—	.7
Jun. 30	38.8	10.1	14.6	13.4	.3	—	—	.5
Sep. 30	32.7	10.3	11.6	9.7	.4	—	—	.7
Dec. 31	18.8	7.1	9.1	1.4	.5	—	—	.6
1925—Mar. 31	20.7	2.9	9.1	7.7	.6	—	—	.5
Jun. 30	26.6	3.5	9.4	12.3	.6	—	—	.8
Sep. 30	29.6	9.0	8.8	10.4	.7	—	—	.8
Dec. 31	21.5	6.4	8.7	5.3	.7	—	—	.5
1926—Mar. 31	30.0	3.5	13.1	12.2	.7	—	—	.5
Jun. 30	35.3	12.3	10.6	11.2	.6	—	—	.7
Sep. 30	37.6	19.9	11.1	5.4	.6	—	—	.6
Dec. 31	34.4	21.5	9.3	2.2	.7	—	—	.7
1927—Mar. 31	35.8	16.1	12.1	6.5	.6	—	—	.5
Jun. 30	46.5	22.4	11.6	11.5	.3	—	—	.6
Sep. 30	38.6	26.9	8.6	1.8	.5	—	—	.8
Dec. 31	38.2	22.6	7.7	6.8	.4	—	—	.8
1928—Mar. 31	40.2	18.4	10.5	10.5	.3	—	—	.5
Jun. 30	47.1	22.0	10.5	13.4	.5	—	—	.6
Sep. 30	42.9	24.8	7.4	9.3	.7	—	—	.7
Dec. 31	40.3	21.1	6.9	11.1	.5	—	—	.7
1929—Mar. 31	39.4	15.3	10.0	13.2	.5	—	—	.6
Jun. 30	45.7	16.9	8.1	19.4	.8	—	—	.5
Sep. 30	43.8	17.4	7.0	18.0	1.0	—	—	.5
Dec. 31	32.6	12.4	5.0	13.8	.9	—	—	.5
1930—Mar. 31	44.7	8.5	9.2	25.9	.8	—	—	.3
Jun. 30	54.5	12.8	7.1	33.1	1.2	—	—	.4
Sep. 30	47.4	13.2	6.0	25.9	1.4	—	—	1.0
Dec. 31	36.9	8.1	5.1	21.8	1.2	—	—	.7
1931—Mar. 31	41.0	2.0	10.2	27.0	1.2	—	—	.6
Jun. 30	48.6	9.7	8.1	28.9	1.4	—	—	.5
Sep. 30	39.0	8.1	3.1	25.6	1.5	—	—	.6
Dec. 31	32.1	1.5	3.1	25.9	1.2	—	—	.5
1932—Mar. 31	42.3	—4.6	17.0	28.3	1.1	—	—	.5
Jun. 30	43.3	—1.4	14.8	28.0	1.3	—	—	.6
Sep. 30	27.4	.2	2.8	22.0	1.5	—	—	.9
Dec. 31	39.7	—2.6	20.4	19.8	1.5	—	*	.6
1933—Mar. 31	20.5	—6.3	—.6	25.3	1.2	—	*	.9
Jun. 30	31.2	—3.8	2.0	31.1	1.4	—	*	.6
Sep. 30	26.9	—2.6	4.8	22.7	1.0	—	.5	.6
Dec. 31	25.6	—4.1	5.2	21.9	.9	—	1.0	.8
1934—Mar. 31	40.7	—5.6	17.7	25.9	.8	—	1.3	.6
Jun. 30	47.6	—.7	18.7	27.3	1.1	—	.4	.8
Sep. 30	51.2	2.1	19.8	27.2	1.1	—	.1	1.0
Dec. 31	72.4	8.4	39.3	22.8	1.1	—	.2	.7
1935—Mar. 31	53.4	9.5	13.2	29.0	1.0	—	.1	.6
Jun. 30	53.8	10.1	16.8	25.2	1.1	—	.2	.4
Sep. 30	58.6	16.8	17.0	22.0	1.3	—	.5	1.0
Dec. 31	55.9	16.5	14.6	21.5	1.2	—	1.2	1.0
1936—Mar. 31	61.1	13.9	18.3	24.5	1.1	—	1.9	1.4
Jun. 30	58.2	11.9	20.0	21.0	1.2	—	2.6	1.6
Sep. 30	62.8	18.2	17.0	21.8	1.4	—	3.2	1.3
Dec. 31	54.2	14.6	11.4	22.2	1.3	—	3.8	1.1
1937—Mar. 31	65.6	11.8	16.6	31.2	1.1	—	4.1	.9
Jun. 30	68.3	14.4	19.4	28.7	.9	—	3.5	1.4
Sep. 30	67.7	24.7	16.3	24.0	.9	—	.5	1.2
Dec. 31	62.5	21.7	13.5	24.8	1.0	—	.6	.9
1938—Mar. 31	111.2	22.9	14.6	32.4	.8	39.0	.6	.9
Jun. 30	139.5	24.7	16.0	32.2	.8	63.5	.5	1.6
Sep. 30	167.1	26.9	14.4	22.8	.8	99.9	.4	1.9
Dec. 31	175.5	21.9	12.3	22.3	1.0	115.9	.5	1.6
1939—Mar. 31	200.8	15.8	16.8	29.3	.6	136.2	.8	1.3
Jun. 30	220.3	15.5	17.7	30.7	.7	153.0	.7	2.1
Sep. 30	225.0	16.3	16.0	26.1	.8	162.8	.6	2.3
Dec. 31	222.7	10.6	13.9	23.7	1.0	170.5	1.0	2.0
1940—Mar. 31	240.0	7.0	16.8	31.4	.6	181.0	.9	2.3
Jun. 30	252.2	10.5	17.8	34.3	.6	184.8	1.2	3.1
Sep. 30	255.2	12.4	16.8	29.4	.9	190.9	1.4	3.5
Dec. 31	245.7	8.9	13.2	29.9	1.1	188.1	1.6	3.0
1941—Mar. 31	273.3	7.0	18.7	41.8	.7	199.0	2.0	4.1
Jun. 30	295.6	13.3	19.0	43.2	.9	212.3	2.3	4.6
Sep. 30	327.2	30.5	19.8	39.4	1.2	227.7	3.5	5.0
Dec. 31	348.3	31.8	15.9	42.9	1.3	245.3	6.7	4.5
1942—Mar. 31	382.3	36.4	19.5	52.5	1.2	260.7	7.3	4.7
Jun. 30	407.0	42.4	19.3	55.3	1.4	273.6	10.1	5.0
Sep. 30	432.7	57.1	18.8	49.6	2.0	288.4	10.9	6.0
Dec. 31	451.2	60.0	16.5	46.7	2.2	310.9	11.4	3.6
1943—Mar. 31	488.4	62.2	21.2	53.2	2.1	334.4	12.0	3.3
Jun. 30	514.3	68.4	21.0	58.1	2.3	348.0	13.8	2.6
Sep. 30	535.8	80.6	19.7	51.7	2.9	363.2	15.1	2.6
Dec. 31	553.2	80.8	20.7	49.1	3.1	382.4	15.3	1.9
1944—Mar. 31	588.7	89.8	19.2	57.6	3.1	400.6	16.3	2.2
Jun. 30	628.5	106.1	17.6	62.4	3.5	420.8	16.2	1.9
Sep. 30	651.1	115.8	18.3	57.1	4.3	442.2	10.9	2.4
Dec. 31	668.9	123.0	15.4	56.4	4.7	463.0	4.4	2.0
1945—Mar. 31	705.6	130.1	17.1	67.9	4.6	480.3	3.7	2.0
Jun. 30	735.2	140.2	17.5	68.4	4.6	499.3	8.4	1.8
Sep. 30	758.5	149.9	19.1	62.7	6.0	512.8	5.4	2.6
Dec. 31	755.2	155.1	19.1	60.7	6.5	505.8	5.5	2.5

[1]Includes General Revenue-Investment and other segregated accounts within the General Revenue Fund.

[2]Includes following funds: Common School; University of Illinois; University Income; Teachers College Income; Blind Relief; Emergency Relief; Occupational Tax; Fire Prevention; Illinois-Michigan Canal; Illinois Veterans Rehabilitation; Soldiers Compensation; U. S. Veterans Bureau; all working and revolving funds; all Federal aid funds other than those treated as accounts in the General Revenue Fund; all bond receipt funds except for highways; all bond interest and principal funds.

[3]Includes Road, Motor Fuel (State, Counties, and Municipalities), and highway bond receipt funds.

[4]Includes Game and Fish Fund and Agricultural Premium Fund.

[5]Includes cash balances only of employees pension and retirement funds; Local Bond; Kaskaskia Common Permanent School; Corporation Trust; Workmen's Compensation.

*Less than $50,000.

SOURCE: *Monthly Report*, Illinois State Treasurer. Balances shown exclude investments in employees pension funds and trust funds other than the Federal Unemployment Compensation Trust Fund. Adjustments have been made in balances of the "operating" funds for interfund borrowing in the years 1931-1938. These adjustments decrease the total balance and that of the "operating" funds by the amount of borrowing on tax anticipation warrants by the General Revenue and "other operating" funds from the "highway" and "other earmarked" funds.

by anticipation warrant loans from the highway funds. Some of the more important funds included in the category "other operating" funds also had deficits in this period. From 1929 through 1934 balances in most of the State's funds were at dangerously low levels.

The highway fund balances have been maintained at comparatively adequate levels throughout the entire period and particularly after the motor fuel tax was adopted in 1929. They presently reflect the accumulation of 30 million dollars over the average balance of prewar years. This growth in balances has not been due to greater tax productivity, as in the case of the General Revenue Fund, but to the inability of the State and its local units to obtain materials and labor for highway improvements and thus to spend even a reduced, earmarked income. Several other State funds are or have been earmarked in the sense that particular revenues are payable only to certain funds and particular expenditures must be limited from the balances available in those funds. Earmarking, however, is here restricted to cases in which it is a definite long-run policy and involves a continued accumulation of surplus rather than transfer to another fund for other State expenditure.

Two minor earmarked funds are treated separately even though they have little fiscal significance: one, the Agricultural Premium Fund, is supported by one-half of the revenue from racing fees and taxes; the other, the Game and Fish Fund, is supported by the income from hunting and fishing licenses and is devoted to wild life conservation.

The Unemployment Compensation Trust Fund and the Protested Fees Fund have had substantial balances throughout the period of their existence, but such amounts are not available for general purposes. The Unemployment Compensation Trust Fund balances are available only for payment of unemployment benefits and may be withdrawn by the State solely for that purpose. The fund itself is invested by the Federal Government in Federal securities. The Protested Fees Fund comprises tax payments from taxpayers who question their legal liability to particular taxes. They pay these taxes under protest, therefore, and the State Treasurer segregates such amounts into a separate account from which refunds can be made without the necessity of appropriations by the General Assembly. The rise and fall in balances in the Protested Fees Fund is thus an indication of the initiation or termination of tax litigation.

OPERATING CASH REQUIREMENTS

With two important exceptions—highways and unemployment compensation—the activities of the State of Illinois are directly or indirectly financed through the General Revenue Fund. This Fund directly receives a large portion of State tax revenues and Federal aid; disbursements from it cover the major state functions. The other operating funds are linked to General Revenue by transfers in such a manner that it can be used to insure adequate cash on hand in other funds or to absorb their excess balances. As the key fund in State finance, General Revenue is required at all times to have an operating balance adequate not only for normal demands but also to meet contingencies arising from unforeseen declines or delays in the receipt of the State's revenues or from unexpected expenditure requirements.

A reasonable estimate of a proper operating balance for General Revenue should take into account the constitutional prohibition against the State's using its credit beyond $250,000 for casual deficits or failures of revenue, the budgetary practices followed by the State, and the anticipated level of economic activity in the state. Inasmuch as for all practical purposes the State must operate on a cash basis, it will need, if it pursues a conservative financial policy, to carry a larger cash balance than if it could resort to temporary loans. The State budget is prepared on a biennial basis, and though not ordinarily approved until shortly before the beginning of the fiscal period, it is of necessity based upon estimates made four to ten months earlier. In a period of rapid change in economic conditions, therefore, even the most carefully prepared revenue and expenditure estimates may be seriously in error before the close of the first fiscal year of the biennium. Against the hazards of such long-run predictions, a substantial balance in the State's principal operating fund is an important protection.

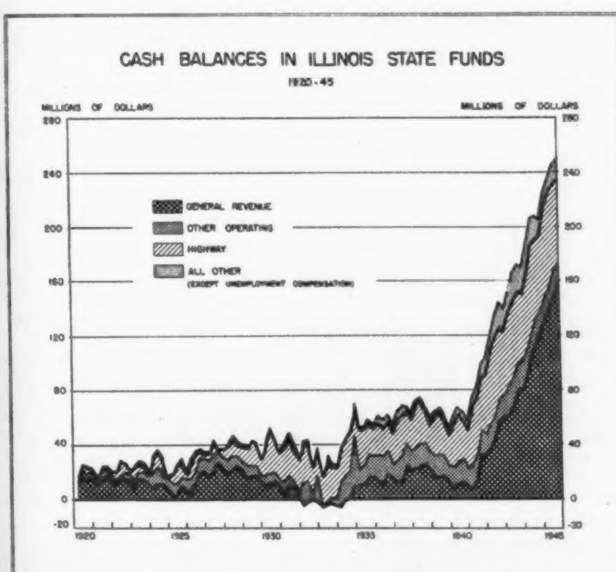
Recent Illinois financial history provides little in the way of a guide to determining the size of a proper operating cash balance. The General Revenue Fund has been very seriously embarrassed on only one occasion, and that arose during the period of the State's reliance on the property tax from the consequences of the depression of the early 'thirties and the delay in tax collections arising from the Cook County reassessment. However, the advantages of an adequate cash balance have not been apparent, because throughout the past 25 years the State has expanded its revenues and expenditures so rapidly that the absolute balances of prior years have had little relative significance. If the level of state finance is reasonably stable in the postwar period, the present balance in the General Revenue Fund may well have an importance proportional to its absolute size. In the absence of historical precedents and the lack of any accepted rule of thumb for a guide, a proper operating balance can probably be only a judgment determination on which there may be some difference of opinion. However, if such judgment rests upon a thorough and detailed knowledge of the State's finances, their relationship to economic conditions, and an informed appraisal of future developments, the range of opinion will not be great.

If the June 30, 1945 balance in the General Revenue and "other operating" funds is expressed in terms of the average monthly tax revenue flowing directly or indirectly into these funds during the preceding fiscal year, that balance is equivalent to between 11 and 12 months' receipts. Both the balance and revenues have since been increasing, and currently the balance is approximately equivalent to a full year's tax receipts. By way of comparison the average balance was between six and seven months' receipts in the fiscal years 1921-24, dropped to less than a four-month yield in 1925 and 1926, and regained the former position in 1927-1929. From that point, the balance declined steadily to a deficit position in 1933. By fiscal 1935, a two months' yield had accumulated which was built up to between three and four months' receipts in 1938 and 1939. After a slump to

a two-month level in 1940 and 1941, the balance has grown steadily to its present proportions. On the basis of this experience, a balance of less than three months' revenue would appear abnormally low, and one of five to six months' reasonably conservative. After making allowance for the "other operating" funds, this would entail a General Revenue balance at the present time of between 60 and 70 million dollars.

Illustrative of this approach to a cash-operating reserve is the budgetary recommendation of Governor Thomas E. Dewey submitted in connection with the New York state budget for 1946-47. Governor Dewey's proposal is to strengthen the financial position of the State and its local governments, to the degree to which they are dependent on state aid, by establishing two tax stabilization reserves—one for the local assistance fund and one for the general state purposes fund. Annual operating surpluses are credited and deficits charged to these reserves, and withdrawals are to be repaid within six years or to the extent of maintaining a reserve of 25 per cent of the most recent annual expenditure. The upper limit of the local assistance reserve is set at 45 per cent of the latest annual expenditure of the local assistance fund, and that of the state purposes reserve at 35 per cent. Transfers may be made from one reserve to the other if the ceiling for the reserve from which transfer is made has been reached. Any excess above these ceilings is available for tax reduction. The projected balance in these two reserves as of March 31, 1947, is estimated at 86 million dollars.

While the institution of a statutory budgetary procedure to insure the maintenance of a proper cash reserve has many advantages, it is not the only means by which such a result can be attained. A conservative budgetary approach can accomplish the same result with less formality if the advantages of a strong financial position are a keystone of state fiscal policy.



NET FARM INCOME

(Continued from Inside Front Cover)

tion and miscellaneous current operating expenses, and a considerably smaller part of the total is required for hired labor. In the District, 25 per cent of the total is absorbed by the miscellaneous group, and nearly one-fifth is represented by maintenance and depreciation. Only about 10 to 12 per cent is absorbed by labor expense. Taxes and farm-mortgage interest are also somewhat more important relatively in the District than in the nation as a whole.

The total of operating and production expense increased by about 75 per cent in the District during the five-year period, 1939-1944. Smallest increase was in Michigan, at slightly over 60 per cent. Iowa's increase was about 90 per cent, while expenses in Illinois, Indiana, and Wisconsin were about 80 per cent higher.

Feed expense nearly trebled for the District during the period, partly due to increases in prices, but the expansion of livestock production was also an important factor in the increased expense for feed purchased. Greatest increase was in Iowa, where the 1944 outlay was estimated to be more than 3¼ times the 1939 expenditure, but the increases for Illinois and Indiana were nearly as great.

In line with the livestock expansion, the expense for livestock purchased also rose during the period. For the District the 1944 expense for this group was about 50 per cent above the 1939 average, but this figure conceals the fact that Michigan showed no increase in expense for livestock purchases, while the remaining four states showed rises of around two-thirds (60 to 69 per cent) for Iowa, Illinois, and Indiana, and 84 per cent for Wisconsin.

The greatest rise for any group was shown for fertilizer and lime expense. About three times as much was expended on this group in 1944 as in the District in 1939. In this class of expenditure price increases were of much less significance than were the additional quantities used in expanding production. Iowa farmers are estimated to have expended nearly seven times as much for fertilizer and lime in 1944 as in 1939, and Wisconsin farmers spent six times as much as at the beginning of the war period. In Illinois and Indiana the expenditures were extended to more than three times the amount at the beginning of the period, while Michigan farmers spent two and one-half times as much in 1944 as in 1939.

Expenses for the operation of cars, trucks, and tractors were of necessity held down somewhat because wartime curtailments kept farmers short of fulfilling their needs for these types of equipment. Even so, expenditures by the District's farmers rose by more than 50 per cent during the five-year period. In Iowa the expense for vehicle maintenance and operation rose by nearly 70 per cent.

Labor was a source of considerable difficulty and irritation during the period. Principal feature of farmers' hired-labor difficulties was the limited supply of competent help. Farmers had to do with less labor on the whole, and such as was available was materially below the level of skill and competence prevailing up to the war period. Expenditures for

hired labor increased by more than two-thirds in the District. Increases in hired-labor expense of 50 to 55 per cent are estimated for Illinois, Indiana, and Michigan. Iowa hired-labor expense practically doubled during the five-year period, and Wisconsin labor expense considerably more than doubled. The somewhat higher rates of increase in these two latter states are largely a reflection of the materially greater relative increase in the wage rates for dairy hands.

The maintenance and depreciation expense for farm buildings, machinery, and equipment rose by 50 per cent in the District. The increase was about the same for each of the five states. Since outlays for buildings and equipment were held in check by wartime shortages, the principal features of the increased expense were the advance in prices and the increased depreciation of existing capital equipment charged to the war years.

Tax expense remained relatively stable. For the District as a whole, the increase was somewhat less than ten per cent. Indiana shows an estimated decline of one per cent for the five years, while a three per cent increase in tax expense is shown for Iowa, ten per cent for each of Illinois and Michigan, and 20 per cent for Wisconsin.

Farm-mortgage interest expense was the only group showing a decline for the war period. For the District as a whole, the decline is estimated at about 17 per cent. Decline of this expense item is due mostly to a reduction by farmers of the principal of obligations outstanding against their lands, but a substantial amount of refinancing has also been done, at reduced rates of interest. Reductions in mortgage interest expense were estimated at 29 and 22 per cent for Illinois and Wisconsin, respectively, and at 13 or 14 per cent for Indiana, Iowa, and Michigan.

The extent to which production and operating expenses have lagged behind gross income of farm operators is shown by the ratio of expenses to gross income. Before the war, expenses were 57 to 58 per cent of gross income in the District, ranging from 55 per cent for Michigan to 60 per cent for Illinois. By 1943 this ratio had dropped to a low of 45 per cent for the District as a whole, ranging from 42 per cent for Wisconsin to 47 per cent for Illinois and running 44-45 per cent for the other three states. For 1944, expenses had begun to overtake gross income, and the District ratio rose to 48 per cent, and was probably still higher for 1945. In 1944 the Illinois ratio had risen to 52 per cent, Iowa to 50, Indiana 48, while for Michigan and Wisconsin the ratio remained at 43 per cent or less.

NET INCOMES LEVEL OFF

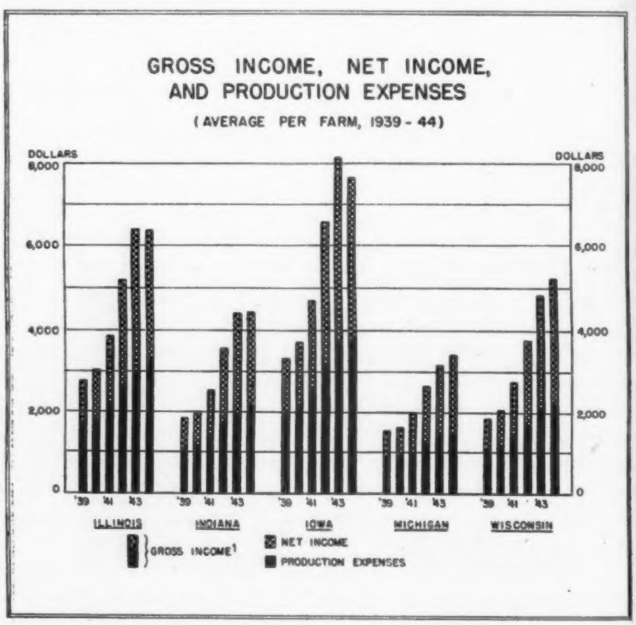
As a result of the rise in operating and production expenses, the net realized income per farm began to level off in 1944. In Illinois the estimated net income in 1939 was $1,094 per farm. It rose to a peak of $3,363 in 1943 and dropped back to an average of $3,080 for 1944. Similarly, Indiana's net realized income per farm increased from $737 in 1939 to $2,435 for 1943, and declined to $2,280 a year later. In both states the declines in net came in spite of increases in gross income, expense having increased faster than gross income.

At the beginning of the five-year period, Michigan's estimated net income per farm was $678. It continued to rise through the period, reaching $1,790 in 1943 and $1,947 in 1944. The Wisconsin average was $781 in 1939, rose to $2,790 in 1943 and $3,045 in 1944. In both states gross income and expense increased in 1944 over 1943, but the returns were such as to leave a larger net in 1944 than in 1943.

For Iowa the net income per farm in 1939 was $1,383, reached a peak of $4,513 in 1943, and dropped to $3,856 for 1944. This large decline was the result of a sharp drop in gross income in addition to the increase in production expenses.

These estimates of gross income, expense, and net realized income throw an interesting light on the agriculture of the District. It is customary to think of such states as Iowa, Illinois, and Wisconsin as being among top-ranking agricultural states of the nation. Measured in terms of cash receipts from farm marketings, such states do rank up near the top. In 1944 Iowa was second, Illinois fourth, Wisconsin seventh, Indiana eleventh, and Michigan fifteenth.

But when realized net income is used as a measure of farm welfare or of the return to the farm family, these states do not rank as near the top. Again using 1944 estimates, Iowa ranks only fourth in net income per farm, Illinois drops to thirteenth place, Wisconsin to fourteenth, Indiana takes twenty-third place, and Michigan places thirtieth. Thus a state may rank high in terms of total value of agricultural products, but when due allowance is made for the expenses of operation and production, and the net income is divided over the total number of farms in the state, the farm operator and his family do not appear to enjoy all the economic advantage that is implied in a state's high rank by value of products.



[1]Includes Government payments.
SOURCE: United States Department of Agriculture.

Reconversion in the Seventh District—III

Widespread Economic Controversies Block Badly Needed Production

Despite intensification of some of the most complex economic problems the Seventh District has ever faced, general optimism still pervades the outlook for District employment and business activity for some time after current wage-price-profit controversies are resolved. Prolongation of these difficulties, however, is causing increased inflationary pressures and raising some threat to the duration, if not the level, of the much heralded postwar boom. Over-all reconversion progress, measured by employment, production, and income, of course, has not by any means come to a standstill in this District despite some of the most extensive work stoppages in the nation. Most measures of business activity for this District are now at roughly their immediate prewar (1941) levels with generally excellent possibilities—if not prospects—for considerable future expansion. Several factors favorable to the transition from war to peacetime conditions, present at V-J Day, such as accumulated savings of individuals, financial strength of business firms, relatively greater price-cost certainty and stability, and favorable immediate expectations about general business trends, however, gradually are being dissipated.

Wage-price-profit controversies, it is well recognized, continue to lie at the heart of present domestic economic problems in this District and throughout the nation. Recent months have demonstrated clearly that under present conditions manufacturers are reluctant to produce, or at least to sell, products on which they expect an immediate loss or a future increase in selling price. Inasmuch as innumerable cases of such expected losses under prevailing price ceilings are reported, pressures for price increases are intense, with the result that some further upward price adjustments for many firms seem to be a condition needed to stimulate new and expanded production. The District is still in the "first wave" of strikes for postwar wage increases and allied matters, with another possible wave foreseen later in 1946 or 1947. A comparatively small proportion of the District's 9 million currently employed workers, however, appears to be benefiting as yet from the wage increases granted to wage-earners in some organized industries. Consequently, a striking paradox persists: a need for further price increases to obtain more production at a time when such continuing increases will bring about demands for still higher wage-rates. In other words, the elements necessary for the so-called "inflationary spiral" are definitely present.

Expanded industrial production without substantial price increases can be the only effective check against the vast inflationary forces now operative. The District and the nation probably will be surprised again by the tremendous productive power of industry now ready to be unleashed for peacetime purposes, but there is no assurance now as to when a large volume of badly needed production will be reached. With the output of many goods delayed so long, moreover, even the increased production of scarce items initially may renew temporary dormant ordering of such goods and intensify inflationary pressures upon limited supplies. With prices rising, however, there is always the distinct possibility that general consumer demand—as opposed to the demand of persons anxious to obtain goods without particular attention to price—may react unfavorably, necessarily or by choice, to "excessive prices" and thus shorten the life of the expected boom.

POST V-J RECONVERSION PHASES

Reconversion progress in the Seventh Federal Reserve District, comprising most of Illinois, Indiana, Michigan, and Wisconsin, and all of Iowa, from mid-August 1945 to March 1946 falls roughly into three phases: (1) the initial sharp decline in business activity for about two months after V-J Day as a result of large-scale war contract cancellations; (2) the subsequent partial recovery of employment and business during November and December as some civilian output was resumed; and (3) the production decline and new growth of unemployment since the close of 1945, largely attributable to widespread wage-price-profit controversies and uncertainties as well as continued demobilization. A fourth phase of heavy production, particularly in those industries where output is now lagging, is expected to follow the elimination of the economic bottlenecks which gave rise to the present period.

The first two phases of Seventh District reconversion have been covered in Parts I and II of "Reconversion in the Seventh District," which appeared respectively in the September 1945 and November 1945 issues of *Business Conditions*. Phase three of the transition from war to peace, beginning generally with the new year and marked by widespread uncertainties, work stoppages, and production delays, will continue until the principal wage-price-profit controversies are resolved, or at least to the point where the most serious deterrents to production are minimized. Throughout this period there is the ever-present possibility of either a sharp rise or a sharp drop in production and employment, depending upon whether current negotiations lead to settlements of controversies or a new wave of work stoppages begins.

The present industrial situation forcefully demonstrates the degree of interdependency which exists in our economic system. Interruptions in the flow of specific materials and parts quickly have forced cumulative shutdowns of plants seemingly far removed. The secondary effects of strikes upon production and workers in other plants and industries often have been at least as severe as the original work stoppages themselves. The fact that production of many badly needed

consumers' durable goods has been interrupted appears to have magnified total output losses. Actually, work stoppages in some of the most basic industries in the District and the nation, however, have not halted or even reduced many types of manufacturing activity. Production of perhaps two-thirds of the District's manufactured products, including innumerable smaller and less conspicuous items, has continued at high levels throughout the current unsettled phase of reconversion.

MANUFACTURING OUTPUT DECLINES

Industrial production in the nation, currently estimated at about 45 per cent above the 1939 rate, is at the lowest level since the early part of 1941. The Seventh District situation is closely parallel. A five per cent decline in total output has occurred nationally since the close of 1945, involving principally the leading manufactures of the Seventh District.

While total output of goods in this District as in the nation is about the same as in early 1941, there are marked differences in the production rates among individual industries. Manufactured food products and chemical products, for example, are being produced at a rate considerably higher than in 1941, but automobiles, certain electrical appliances, and in fact most of the larger consumers' durable goods are at a rate of output much lower than that of the prewar period. According to the Civilian Production Administration, the January 1946 production rates for several leading Seventh District products were well below earlier expectations, e.g., radios, only about 45 per cent of prewar monthly output; electric irons, about 76 per cent; and electric stoves, less than 50 per cent.

The Seventh Federal Reserve District currently appears to be more seriously affected by lagging production than other parts of the nation. Most of the major strikes attracting national attention in recent weeks, including electrical machinery, meat packing, automobiles, farm machinery, and iron and steel, have been centered in, or highly important to, this District. In January 1946, more persons were out of work because of strikes and lockouts than in any previous month. Of the 1,750,000 persons reported by the United States Bureau of Labor Statistics to have been directly involved in strikes and lockouts in the United States during January 1946, over 400,000 or 23 per cent, were in the Seventh District.

Manufacturing employment in the Seventh Federal Reserve District continued to rise until mid-January 1946 to a level almost three per cent above that of the preceding month. Thereafter, a decline set in as strikes and plant shutdowns affected an increasingly large number of workers. While strikers in general are not eligible for unemployment compensation benefits in this District, workers indirectly laid off because of strikes are eligible, and such applicants brought the total number of claims in the District to more than 370,000 during January and February from a post V-J low of 340,000 in December. In addition, approximately 200,000 unemployed veterans in the District were receiving readjustment allowances under the G.I. Bill of Rights.

POSSIBLE LOSSES IMPEDE OUTPUT

Examination of both the volume and characteristics of current production and the supply of goods actually for sale clearly reveals, as indicated, that manufacturers under present conditions are reluctant to produce and sell merchandise when losses are anticipated. Some of the current lag in output and distribution apparently can be attributed directly to prices which are not considered by individual firms to be high enough to permit profits and to the general uncertainty about possible price relief following recent and current wage and other cost increases. As a result, some manufacturers are reported to have suspended operations and many others are known to have shifted to new models and products which offer better prospects of profits than some of their regular lines. The distinct possibility of further upward price adjustments, in fact, is in itself an important hindrance at present to large-scale production and distribution of goods.

At the time the war with Japan ended, there were widespread predictions that new all-time records in production, especially of consumers' durable goods, would be established during 1946 because of the greatly expanded productive capacity available, plus a considerable backlog of effective demand. In recent weeks, however, many firms have lowered their sights for 1946 as delays caused by strikes, material shortages, and labor shortages have become increasingly serious. Many businessmen in this District now report that this year's production may not even reach the best prewar levels attained in 1941, if current industrial uncertainty and strikes are prolonged much further. The farm equipment industry, for example, had planned a new record volume of farm equipment in 1946, but major firms now hope only to be able to equal 1945 output, which was considerably under the record high of 1941. Automobile manufacturers, moreover, who early last fall believed they could attain a rate of five to six million cars a year by this spring, currently have lowered their expectations to three million vehicles.

While businessmen continue to have utmost confidence in the existence of a huge backlog of demand for many of their products, some questions are now being raised as to the ability of most consumers to finance more than one important consumer durable good purchase at any one time, especially at present and expected price levels. In other words, while most consumers may be anxious to own a wide variety of new products, including automobiles, furniture, and appliances, it is highly unlikely that the bulk of them will be able or willing to finance from current income, or buy from accumulated savings, more than a very limited number of items at any one time. As a result, more attention is being given to the probable order in which these purchases will be made. Industries and firms which have the earliest production may have certain marked advantages over others in tapping the so-called backlog of demand, as it applies to any particular family unit. The necessity for consumers to buy many goods in sequence rather than all at once promises to level off, and probably to extend the duration of, the backlog of demand as it is now viewed by some business firms. This foreshadows a return to active sales competition in many lines perhaps sooner than now expected.

DISPUTES HAVE WIDE EFFECTS

Not only has Seventh District production declined and the number of idle from strikes and demobilization mounted since the first of the year, but the effects of wage-price-profit controversies can also be seen in the financial status of some business firms, accumulated savings of many individuals, and consumer expenditures, particularly in the industrial areas most seriously hit by work stoppages.

At the end of 1945, some four months after V-J Day, business firms in the nation and in this District on the average had a stronger liquid position than they did the month following V-E Day. This average betterment of current position was due in no small measure to the speed with which war contract terminations have been handled. A sample study of over 4,000 terminated contracts reveals, moreover, that requests for advance payments of any kind were made in less than 10 per cent of the cases. T loans through the Federal Reserve Banks and partial payments by the armed services have been available within an average of two weeks after application, so that companies have not been obliged to wait for actual terminations to receive cash. In addition, in January and February of this year business firms in the nation cashed over a billion dollars in excess profits tax refund bonds.

FINANCIAL POSITIONS WEAKENED

The average improved financial position of businesses between June and December 1945, however, should not obscure the fact that some companies have behaved counter to trend, particularly during the last few months. Companies whose financial position weakened after June 1945 fall into two main groups, namely, (1) those which were inherently weak throughout the war, and (2) those, mainly in metal working, which expanded considerably during the war and which have since been shrinking back to their prewar size. The general weakening in financial status in the last few months is due largely to the slowing up of reconversion progress attendant upon strikes and uncertainty over the Government's wage-price-policy. For most companies the recent common decline in current assets is by no means serious, but a number have begun to experience some financial difficulties. Curtailed production and output for inventories rather than sales, pending reconsideration of price requests by OPA, have caused recent financial statements of many companies to show losses and a deteriorating current position.

The cushioning effect of accumulated savings upon individual expenditures and community business life during periods of work stoppages has been amply demonstrated during the current unsettled phase of reconversion in the Seventh Federal Reserve District. Equally apparent, however, is the fact that accumulated savings, once used to maintain families and communities affected by work stoppages, cannot be counted upon later for purchases of consumers' durable goods or for support during any future periods of unemployment. Gary, Indiana, District steel center, and Flint, Michigan, key city in the U.A.W.-General Motors controversy, are two important illustrative Seventh District industrial areas which have experienced widespread strikes in their principal manufacturing plants. The steel strike extended 28 days from January 21 to February 17 for the basic metal producers, and is still in progress for steel fabricators. The General Motors strike continued 113 days, from November 22 to March 13. Primarily because of accumulated savings of workers and their families, the extension of considerable credit by business firms, and the availability of some funds from public and private sources to aid destitute workers and their families, general business activities in Gary and Flint have been maintained at unexpectedly high levels despite the complete shut-down over extended periods of basic income-producing plants.

GARY BUSINESS REMAINS HIGH

Throughout the four weeks' strike the general assumption in Gary that the vital role of steel as a basic material for other manufactured products would necessitate Government intervention and a quick resumption of production if labor and management were unable to settle their disagreement helped sustain the city's economic life. Continued confidence has followed the strike settlement because the steel industry, even though operating at capacity throughout the remainder of 1946, is not expected to be able to meet the demand that will exist. Although roughly five per cent of the families of Gary's 23,000 unemployed steel workers required public assistance, the bulk of the workers had sufficient funds available to carry them through the period of idleness. Retail sales decreased as a result of the strike, but less than anticipated, and public demand for scarce commodities continued at very high levels. The most significant effects of the city's work stoppage were the reduction in the amount of savings and the increase in claims on future income resulting from additions to charge accounts and other deferred payments carried over from the strike period.

Somewhat more serious economic difficulties have arisen in Flint than in Gary because the automobile strike has been of longer duration, and pre-strike unemployment was more extensive during physical reconversion of local plants. Less than five per cent of the 35,000 unemployed workers, however, have been receiving public relief. Retail sales have declined eight per cent from a year ago, but the demand for scarce low-cost items remains high. Savings accounts and war bond holdings have been steadily drawn upon. Many Flint automobile workers have learned to manage personal savings during previous periods of unemployment when retooling for new automobile models has been in process, but the length of the present strike has clearly depleted their savings more severely than in Gary. This means a more serious threat, consequently, to future spending for many needed consumers' durable goods. In addition, it is recognized locally that the introduction of 1947 automobile models will create another period of unemployment.

SEVENTH FEDERAL

RESERVE DISTRICT